

THE ENTREPRENEUR WATCH

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Informal Venture Capital

Business Angels and Family & Friend Investors



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1. EXECUTIVE SUMMARY

Informal investors play a vital role in the development of new businesses, yet there is relatively little published material relating to informal investors in Ireland. In this briefing note we outline the extent of informal venture capital investment activity in Ireland.

Key findings are:

- Informal investors invested approximately €275 million in new business during 2011.
- Informal investors, such as family, friends and colleagues, provided at least €195 million in 2011.
- Business Angels invested approximately €80 million in 2011.
- Informal venture capital funds exceed formal venture capital funds in Ireland. For every €1 of formal venture capital funding, there is approximately €5 of informal capital funds.
- About 28,000 'Family, Friends and Colleagues' provide money to new businesses every year.
- About 3,000 Business Angels provide money to new businesses every year.
- Informal investment activity is lower in Ireland than it is in the US and in many other European countries.
- At least one in five informal investors has prior experience of starting a business.

This briefing note uses data from the Global Entrepreneurship Monitor (GEM), the European Private Equity and Venture Capital Association (EVCA), and the Irish Venture Capital Association (IVCA)ⁱ.

2. INFORMAL INVESTORS IN IRELAND

Informal Investors

An informal investor is an individual who provides funds to a business start-upⁱⁱ. These investments are typically in addition to the funds that the entrepreneur(s) put into the new business.

Informal investors can be categorised into two groups, depending on their relationship with the entrepreneur.

- Family, Friends and Colleagues. These people invest in the new business of someone that they already know. The money provided by these investors is often referred to as "love money"ⁱⁱⁱ.
- Business Angels. These people invest in new businesses where there is no pre-existing relationship with the entrepreneur. This money is sometimes referred to as 'smart money' as in addition to their cash investment, the Business Angel may provide the entrepreneur with business advice, access to contacts, etc.

In Ireland, the 2011 Global Entrepreneurship Monitor (GEM) study reported that 93,000 informal investors provided funds to new businesses during the three year period 2009 to 2011^{iv}. This is about 31,000 people each year.

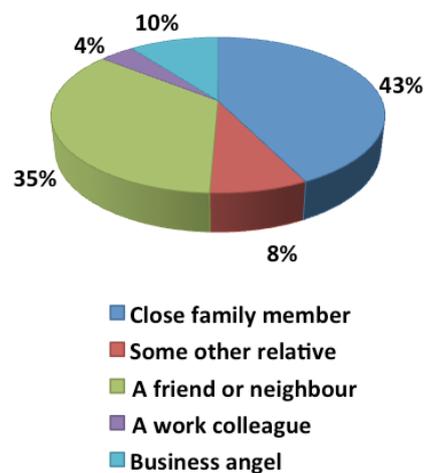
The vast majority of these informal investors had a pre-existing relationship with the entrepreneur. That is, in 2011 approximately 28,000 were so called 'love money' investors.

A minority of these informal investors are Business Angels. In 2011 approximately 3,000 Business Angels made investments in Ireland.

Figure 1 provides a more detailed breakdown of Irish informal investors and their relationship with the entrepreneur they invest in.

Approximately half (51%) of informal investors invest in a new business started by a relative, 35% invest in a new business started by a friend or neighbour, and 4% invest in a new business started by a work colleague. Of all informal investors, 10% invest in a new business started by an individual with whom they have no previous relationship.

Figure 1 Relationship between informal investor and entrepreneur



Source: Irish GEM data

Amounts Invested

Most informal investments are for relatively small amounts. An entrepreneur's own funds and small amounts of informal investment are the resources that entrepreneurs typically must rely on when starting a new business.

Eight out of every ten (80%) informal investors provided funds of less than €25,000 (Table 1). Two out of every ten (20%) invest more than €25,000.

The median investment amount is €7,000, while the mean investment amount is €26,000.^v

Table 1: Investment amounts

Investment amount	Percentage of informal investors
€1 - €10,000	60%
€10,001 - €25,000	20%
€25,001 - €50,000	10%
€50,000+	10%

Source: Irish GEM data

International Comparisons

Approximately 3% of Irish adults are informal investors (Table 2).^{vi} That is, for every 100 adults in Ireland, approximately three have provided funds to a new business during the past three years.

This rate is lower than the average for EU countries^{vii} (4.6%), and for the US (4.8%). It is however higher than the rate in the UK (2.5%) (Table 2).

The average amount invested in Ireland (€26,000) is similar to that for other EU countries and for the US, though it is higher than that in the UK (Table 2).

Table 2: International comparisons

	Informal investors (rate in population)	Average investment
United States	4.8%	€24,000
EU-27 average	4.6%	€23,000
Ireland	3.2%	€26,000
United Kingdom	2.5%	€16,000

Source: Irish GEM data

3. INFORMAL AND FORMAL VENTURE CAPITAL INVESTMENTS

Informal investors are a critical source of funds for entrepreneurs. For entrepreneurs, the informal and formal venture capital market comprises the following groups:

- Family, Friends and Colleagues. These typically provide small amounts of funds at the start-up stage.
- Business Angels typically invest larger (relative to Family, Friends and Colleagues) amounts of funds at the start-up and early stages of development of a new business.
- Formal venture capital funds provide early stage finance to a select few new and young businesses. These businesses must demonstrate that they have the potential to grow to a significant size in a relatively short period of time.

Informal investors, whether they are Family, Friends, Colleagues, or Business Angels, play a complementary role to formal venture capitalists. This is evident in terms of the businesses they invest in, the size of their investments and the timing of these investments.

The extent of informal investment in Ireland is unknown. We provide an estimate of the size of the informal investment market in Ireland.

The Informal Investment Market in Ireland

The majority of informal investors provide relatively small amounts of money to businesses started by a family member, a friend or a colleague. However, given the number of informal investors the total amount of informal venture capital funds is high.

If the 28,000 Family, Friends and Colleagues provide the median €7,000 to a start-up, this accumulates to an annual provision of €195 million. There are two reasons to suggest that this is a conservative estimate of the total amount of informal investment funds. First, by using the median (€7,000), and not the mean (€26,000), we undercount the fewer much larger investments by Family, Friends and Colleagues. Second, the number of investors is based on those in the 18 to 64 age range and therefore excludes investments by those aged 65 and over.

If the 3,000 Business Angels invest the median amount of €7,000, the total annual investment would be approximately €21 million. However, evidence from the UK suggests that investments by Business Angels are much higher (for example, one study from the UK estimated that investments by Business Angels associated with Business Angel networks averaged nearly Stg£200,000).^{viii} For this reason, we use the mean investment of €26,000 to calculate the annual total

investment by Business Angels in Ireland. This suggests an annual investment of €80 million.

Combining these figures suggests that approximately €275m of informal investment funds are invested each year. This is about 0.2 of a percentage point of GNP.^{ix}

The Formal Venture Capital Market in Ireland

The European Private Equity and Venture Capital Association (EVCA) reported that seed, start-up and later venture stage venture capital investments in Irish firms by private equity firms totalled €55 million in 2011.^x This €55 million of formal venture capital was invested in just 67 firms. According to the Irish Venture Capital Association (IVCA), 82 companies in Ireland (this includes Republic of Ireland and Northern Ireland) raised €104.9million^{xi} in 2011.^{xii}

The Informal and Formal Venture Capital Market in Ireland

This data suggests the investment of funds in new businesses in Ireland in 2011 was at least €330 million (Table 3).

For every €1 of formal venture capital funding in Ireland, there is more than €5 of informal investment. More specifically, for every €1 of seed/early stage formal venture capital funds, there is about €1.5 of informal Business Angel funds, and €3.5 of Family, Friends and Colleagues funds.

Table 3: Investments in Ireland (2011)

Investor	Amount	Percentage
Family, Friends, Colleagues	€195m	59%
Business Angels	€80m	24%
Formal Venture Capital Funds	€55m	17%
Total	€330m	100%

4. PROFILE OF INVESTORS

Is there a typical informal investor in Ireland? Given that many informal investors are related to the entrepreneur, there is variety in the profile of informal investors.

There are common characteristics associated with informal investors. Informal investors in Ireland are typically male, have a high level of education, and an above average income. Of particular interest is

that at least one in five informal investors has prior experience of starting a business.

More specifically: 64% are male; 60% have third level education; 50% are from a household in the top 1/3 of the income distribution; and the average age is 38 years (though informal investors are spread across age groups, with 45% younger than 35 years; 19% between 35 and 44 years; and 36% 45 years and older).

5. THE EVOLUTION OF THE INFORMAL VENTURE CAPITAL MARKET IN IRELAND

The funds provided by informal investors such as Family, Friends, Work Colleagues and Business Angels account for the second most common source of finance for entrepreneurs at the start-up phase. The most common source of funds is an entrepreneur's own finance. However, a US study estimated that in many countries, including Ireland, there is insufficient informal investment to meet the needs of new businesses.^{xiii}

This briefing note highlights the extent of informal investment activity in Ireland. The absolute amount of investment is high, €195 million from Family Friends and Colleagues and €80 million from Business Angels. This is high compared to the provision of formal venture capital funds in Ireland.

The number of individuals providing funds to new businesses is high. However, the rate of investment in Ireland is lower than it is in many European countries and is lower than the rate in the US.

A recent trend in the venture capital market is the development of more organised provision of funds from Business Angels. For example, syndicates have emerged that help individual Business Angels to access investment opportunities and to provide opportunities for them to pool their investment funds. These syndicates overcome some of the drawbacks that characterise the informal venture capital market.^{xiv} They also provide Business Angels with the opportunity to learn and share knowledge with peers.

In Ireland, Enterprise Ireland, InterTradeIreland and the Business Innovation Centres (BICs) support Business Angel networks. At a national level, the Halo Business Angel Network (HBAN)^{xv} focuses on the development of business angel syndicates in Ireland. In 2011, HBAN helped to fund 29 new ventures in Ireland with €6 million of Business Angel investment. The main sectors that attracted investment were ICT, Mobile, and Healthcare.^{xvi}

6. ADVICE FOR ENTREPRENEURS

Some questions entrepreneurs should ask themselves before seeking external funds:

- 1 Do you need other people's money to get your business started?

Many successful start-ups begin with relatively modest resources. Some entrepreneurs implicitly adopt a 'lean' approach to the start-up process. This means they seek to minimise the amount of funds needed to get the business started.

- 2 Are you open to allowing others play a role in the strategic direction of your business?
Are you prepared to share ownership?

Getting external finance from a Business Angel will frequently require you to change how you manage your business. Business Angels report that entrepreneurs often have unrealistic expectations when talking to potential investors.

- 3 Does your business have the potential to scale quickly?

If not, don't waste time seeking funds from Venture Capitalists. If your business does have significant growth potential, be ambitious in terms of the pace you seek to grow, and therefore the amount of funds you seek.

- 4 Are you ready for external investment?

Frequently Venture Capitalists report that entrepreneurs are not 'investor ready' when they seek funds. Talk to others who have raised external finance from Venture Capitalists so that you can present your business as an 'investable' opportunity.

Footnotes

ⁱ Entrepreneurship in Ireland 2011, Global Entrepreneurship Monitor The Annual Report for Ireland by Fitzsimons, P. and O'Gorman, C. (2012) [report available on www.forfas.ie]; European Private Equity and Venture Capital Association (EVCA) Yearbook 2011, www.evca.com; www.ivca.ie

ⁱⁱ Investments in traded stocks and shares, mutual funds, etc. are typically excluded from definitions of informal investment activities.

ⁱⁱⁱ Mason, C. M. (2006) 'Informal Sources of Venture Finance', in S. C. Parker (ed.) *The Life Cycle of Entrepreneurial Ventures*, pp. 259–99. New York: Springer.

^{iv} The period is June 2009 to June 2011.

^v The median is the midpoint of all investments. The low median reflects the fact that many investments are quite small. The mean is much higher because a small number of investments are quite large.

^{vi} Adults are those aged 18 to 64 inclusive.

^{vii} Not all European countries are included. See the 2011 Global Entrepreneurship Monitor Report for Ireland for further details.

^{viii} Mason, C. and R. Harrison, (2010) *Annual Report on the Business Angel Market in the United Kingdom 2008/09*.

^{ix} Central Statistics Office, Quarterly National Accounts, (March 2012).

^x This figure relates to investments in companies in Ireland regardless of the location of the private equity firm (EVCA Data).

^{xi} The IVCA present deals includes investments in Irish SMEs.

^{xii} The Irish Venture Capital Association (IVCA), reports that in total 159 Irish technology companies raised €274m from investors in 2011, of which 38% (€105) was seed/early stage investments. A much higher percentage of venture capital money was in seed/early stage investments in 2011 compared to previous years. This compares to seed/early stage investments of €53.6m (in 63 companies) in 2010 and with €71.2m (in 65 companies) in 2009.

^{xiii} Bygrave, W. and Quill, M. (2006) *Financing Report Global Entrepreneurship Monitor*.

^{xiv} Mason, C. M. (2006) 'Informal Sources of Venture Finance', in S. C. Parker (ed.) *The Life Cycle of Entrepreneurial Ventures*, New York: Springer, pp. 259–299.

^{xv} <http://www.businessangels.ie/>

^{xvi} 'Raising Business Angel Finance' by Michael Culligan, HBAN National Director. A seminar presented at DCU (28th May 2012).

DCU Ryan Academy is a non-profit, joint venture between Dublin City University and the family of the late Tony Ryan (Ryanair), focusing on entrepreneurship and innovation in Ireland.

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